EQUITABLE LIFE ASSURANCE SOCIETY
UPDATE FOR GUERNSEY BRANCH POLICYHOLDERS

1. The Commission continues to monitor developments in connection with the Equitable Life Assurance Society ("Equitable"). Regular meetings are held with the FSA and the Legal Advisors to Equitable to discuss issues and any developments which may affect the interests of policyholders of Equitable's Guernsey branch. Recently our attention has been focused upon: any issues arising out of the publication of the long awaited report from the Right Honourable Lord Penrose; the potential further investigation by the Parliamentary Ombudsman; the entitlement to potential redress available to policyholders through the Financial Ombudsman Service and Equitable's own scheme; and the implications of various action group initiatives.

2. Before commenting further in relation to each of those issues, we set out below a brief overview of the relevant factual background to the present situation.

Background and Current Status

The Scheme Arrangement

3. The well publicised House of Lords' decision in July 2000, which confirmed that Equitable's differential terminal bonus policy was unlawful, produced a number of highly significant consequences for the company. Most dramatically, it immediately announced it was putting itself up for sale. In addition, and irrespective of any potential sale, Equitable was required to make provision in respect of the Guaranteed Annuity Rate ("GAR") policyholders and Non-GAR policyholders who had been adversely affected by the unlawful bonus policy. Equitable accepted, after the publication of a number of lengthy and detailed legal opinions, that in addition to compensating GAR policyholders who had been in receipt of benefits calculated incorrectly under the unlawful policy, they should provide redress to the non-GAR policyholders in recognition of their claim to have been mis-sold policies (based upon Equitable's failure to properly recognise the impact of the GAR liability upon the investment performance of the non-GAR contracts).

4. Equitable recognised the considerable financial uncertainty caused by the potential claims of both non-GAR and GAR policyholders all of which arose as a result of the interlocking liabilities created by the GAR benefits. In an attempt to remove this uncertainty they invited creditors to agree a Scheme of Arrangement ("Scheme") with the company. In this case, the proposal would create a binding compromise between the Company and all of those people who had a with-profits policy in force at the effective date, namely 8 February 2002.

5. In general terms a Scheme (made pursuant to Section 425 of the Companies Act 1985) is a legally binding compromise made between a company and its members or creditors or any class of member or creditor. The key feature of a Scheme is that, provided it is approved by a vote in favour by creditors, and is sanctioned by the court, it is binding upon all creditors whether or not any individual policyholder might have chosen to reject the proposal or elected not to vote at all. In this case, all then current policyholders were creditors of Equitable.

6. In summary, the compromise created by the Scheme involved policyholders agreeing to accept specific policy value increases at rates which varied depending upon whether a policyholder was a GAR or a non-GAR policyholder. In return, the policyholder was required to provide an all encompassing waiver of his rights and ability to pursue any and all GAR-related claims against Equitable. The waiver of claims extended to claims which might have been brought before the relevant Ombudsman as well as claims which could have been issued in court.

7. The Scheme was approved by the required voting majority and sanctioned by the courts. The Commission instructed London lawyers (a team led by Peter Hardy formerly of Norton Rose and now with Morgan Lewis) to prepare a report on the extent to which the proposed Scheme may raise distinct issues for Guernsey policyholders. A copy of that report was published on the Commission's website **[Guernsey Financial Services Commission]**.

8. Guernsey policyholders were included within the Scheme proposals. As the lawyers report identified, all policyholders (including Guernsey policyholders) who wished to ensure that they were not bound by the scheme would need to terminate their policies by the Scheme's effective date. Whilst such a termination may well have involved an immediate financial penalty those policyholders that did so would not be bound by the Scheme and would remain at liberty to pursue their claims against the Society.

Previous investigations

9. The severe problems faced by Equitable in the wake of the House of Lords judgement has been analysed in four formal reports. The first to be published was the report of the Corley Committee published by the Faculty of Institute and Actuaries in September 2001. The second was the report of the Financial Services Authority, which covered a review of the regulation of the Society between 1 January 1999 and 8 December 2000. That report, commonly known as the Baird Report, was published on 17 October 2001. The Parliamentary Ombudsman published her initial report on 30 June 2003, and the most comprehensive report of all, the report of the Right Honourable Lord Penrose, was published in March 2004. **[Parliamentary Ombudsman] [Penrose Report]** This combination provides an exhaustive analysis and factual investigation covering a very wide range of issues. Any policyholder

wishing to know more about the background should find all relevant information in one or more of these reports.

Current Status

10. Although there has been much speculation over the solvency of Equitable, the current position is that it is solvent and its financial status is monitored regularly by the Financial Services Authority as its prudential regulators (see paragraphs 31 and 33 below). It is currently and is likely to remain a closed fund. Since 2000 it has taken a number of steps to stabilise its financial position and has adopted a conservative investment strategy as befits a company in its position. A thorough explanation of the governance of Equitable's business, the rationale behind its investment strategy, and the explanation of the risk profile attaching to the with-profits policies is contained in Equitable's Principles and Practices of Financial Management ("PPFM"). **[Equitable Life]**. It continues to pursue litigation against former board members and advisors (in particular Ernst & Young, its former auditors) in relation to the decisions taken in previous years which are considered to have contributed to its current difficulties.

The Penrose Report

General Overview

11. It is self-evident from the 800 pages of report and financial tables published by Lord Penrose that his was an exceedingly extensive and thorough review. His remit was,

> *"To enquire into the circumstances leading into the current situation of the Equitable Life Assurance Society, taking account of relevant life market background; to identify any lessons to be learned for the conduct, administration and regulation of life assurance business……"*

12. The report contains considerable criticism of the management of the company, in particular the inability of the Board to offer effective checks and balances to the actuarial executive and also criticism of the regulatory regime (including the Government Actuaries Department ("GAD")) in operation at the time.

13. In the words of Charles Thompson, Equitable Life's Chief Executive,

> *"Lord Penrose has found that things did go wrong and he has highlighted serious failings by the Society's former directors and also with the regulatory regime in place at the time."*

14. However, whilst it is clear that the report contains some strong criticism, Lord Penrose avoids forming any views as to liability. In fact he concludes that, effectively, the nature of his enquiry made it inappropriate for him to do so and he commented,

> *"it was not for me to measure any persons actions against accepted standards of conduct……breach of duty and the financial consequences of breach are properly matters for the established Courts of Justice or for other appropriate Tribunals in the Financial Sector."*

15. The fact was that Lord Penrose was unable to draw any conclusions on any liability that may flow from his findings but the Report does contain a thorough assessment of what, in the opinion of Lord Penrose "did go wrong". Following the publication of the Penrose Report, there has been a significant and steadily increasing lobby aimed at persuading the Parliamentary Ombudsman, who has the statutory power to recommend compensation, to reopen her enquiry into Equitable Life. Subject to the issues discussed under the heading below, it has been announced that she will do so.

16. In broad terms there have been three related, but distinct consequences, arising out of the Penrose Report. First, the thoroughness of the investigation, the conclusions reached and criticisms made, have, as referred to above, been instrumental in calling for a reopening of the Parliamentary Ombudsman's enquiry. Secondly, the report identified a potential further source of claims against the Society ("the over-bonusing claims"), and lastly, being mindful of his remit to "identify lessons to be learned", a number of further reviews of life insurance business have been instigated. The Commission continues to monitor the developments in relation to each of these three aspects for any potential impact on the interests of Guernsey policyholders.

Parliamentary Ombudsman

17. The Parliamentary Ombudsman initially reported on 30 June 2003, some while prior to the publication of the Penrose Report. The Ombudsman's findings recognise the relationship between her investigation and that of Lord Penrose. The Parliamentary Ombudsman's report outlines the sequence of events which led to her investigation being carried out. It is clear that she was uncertain over the extent of any connection with the overlap of the Penrose Report. The Parliamentary Ombudsman comments,

> *"It was uncertain whether [the Penrose Report] would address a key question for policyholders: that of redress……".*

18. Of course we now know, and as Lord Penrose expressly recognised, that he did not address this key issue.

19. The Parliamentary Ombudsman's initial Report was limited to the period of time covered by the earlier Baird Report. The investigation was commenced by the current Ombudsman's predecessor. When Ann Abrahams (the present Ombudsman) was appointed in November 2002 she reviewed the scope of the investigation. She commented

> *"In light of the fact that it had become clear that the Penrose Enquiry, which was looking at all aspects of these events was prepared to make adverse findings about any of the relevant parties should the evidence justify this, I saw no basis at that time to depart from the decision taken by my predecessor to limit the scope of my office's investigation to the time period covered by the Baird Report".*

20. She also commented that she would await the outcome of the,

> *"wider Penrose enquiry before deciding whether or not it would be appropriate for this office to look at the period before 1 January 1999.*

21. On the publication of the Report she commented however,

> *"that I have decided, therefore, to exercise my discretion under the 1967 Act not to investigate further claims about the prudential regulation of the Equitable."*

22. Subsequently, in the Ombudsman's annual report for the year 2000/2003, published in July 2003, the Ombudsman reiterated that she was not inclined to investigate matters.

23. By way of a very short summary of her initial Report she found,

> *"no evidence to suggest that the FSA acting as prudential regulator had failed in their regulatory responsibilities in respect of Equitable Life during the period in question."*

24. In essence, this conclusion was consistent with the findings of the Baird Report. It was of course a conclusion limited to the narrow time period in question (the same period of time as covered by the Baird report).

25. Following the publication of the Penrose Report there has been sustained pressure upon the Parliamentary Ombudsman to reopen or reconvene a further investigation widening the scope of her former enquiry. She now appears to

have agreed to do this for the reasons set out in her report presented to Parliament on 19th July 2004. **[Parliamentary Ombudsman]**

26. The Ombudsman has agreed that she will reopen her enquiry into the prudential regulation of the Equitable.

27. The Ombudsman considers that the Penrose Report contains prima facie evidence of maladministration by GAD and others responsible for prudential supervision. The criticisms made by Lord Penrose and the material that he produced make it arguable (in the Ombudsman's view) that GAD was maladministrative. However, the factual statements made by Lord Penrose do not represent undisputed findings of fact. Key parties dispute certain factual conclusions made in the report. The Ombudsman is not able simply to adopt the Penrose Report as amounting to "findings of fact" upon which she can base her own further enquiries. Accordingly, she has confirmed that she will conduct a further investigation as a full statutory enquiry without the benefit of hindsight and without the influence of her personal opinion on what the relevant policy should have been. She will assess whether the public body did what it ought to have done and acted without maladministration as judged by the standards applying at the time. She has emphasised that by agreeing to conduct a further investigation, she is not pre-judging the outcome.

28. Importantly, she has not yet decided what will be the timeframe covered by her report. She is minded to focus on events relevant to the closure of Equitable to new business but has confirmed that she will invite further representations on this important question. Possibly she is mindful of the judicial review proceedings raised in connection with the scope of her previous enquiry (see paragraph 42 below).

29. Lastly, she has admitted that it is not known how long the investigation will take to complete.

The Over-Bonusing Claims

30. Following the publication of his report, both the Equitable Life and the FSA commenced an enquiry as to whether Lord Penrose had identified a potential area of further claims arising out of Equitable's policy on the allocation of bonuses, in particular during the period between 1989 and 2001 ("the over-bonusing claim"). Lord Penrose identified the potential area of claim in the following way,

> *"…there was a shift in the policy adopted by the Society during the 1980s and 1990s towards terminal bonus as an increasing proportion of total allocation which in the absence of any coherent or consistently applied smoothing policy resulted in the Society beginning to over allocate from the late 1980s onwards with the*

> *effect that the realistic financial group position.… …was progressively weakened…"*

31. The principal concern of the FSA was whether the possibility of claims arising might have significant consequences for the solvency of Equitable. The Equitable was concerned to assess the realistic likelihood of a material number of claims being upheld against it.

32. Both Equitable and the FSA have now concluded their enquiries into this area of potential new exposure, Equitable's PPFM, (see paragraph 10) under the section, "Key Business Risks", Section 8.2.3 (j) summarised its position as follows,

> *""the Board" has been advised that any claims regarding alleged "over allocation" would face very significant difficulties and that a claim effectively seeking to recover losses relating to investment conditions would be highly unlikely to succeed."*

33. This broad conclusion would appear to be shared by the FSA who have also confirmed,

> *"that the [Penrose Report] does not provide the basis for additional claims that would threaten its solvency…. the FSA has also concluded that generic claims against Equitable Life regarding its basis for allocating bonuses during the 1990s are unlikely to succeed."* **[FSA]**

"Lessons to be Learned"

34. As a direct result of the publication of the Penrose Report the Government has already announced a number of further wide-ranging reviews which affect Life Insurance business generally. These relate to the corporate governance arrangements applicable to mutual life offices (a report led by Paul Myners), the actuarial profession (led by Sir Derek Morris), and a review into the accounting for with-profits business of life insurance, to be conducted by the Independent Accounting Standards Board.

35. At the heart of these reviews, and one of the key findings of the report, was the criticism levelled by Lord Penrose at the corporate governance (or lack of it) displayed within Equitable which has highlighted issues of broader consideration for the management of Life Offices generally. These criticisms were directed at (amongst other things) the rôle of Executive Directors, their qualification as effective managers of a Life Office, and their ability to properly assess and challenge, where necessary, advice from the company's actuaries. He was critical of the process of new product innovation and with

communications to policyholders, calling for better quality of disclosure and greater transparency. Actuarial practices were criticised in a way which not only identified weaknesses in the specific actuarial management of Equitable, but also more generally in relation to the rôle of the appointed actuary and the relationship with the Board. As for the regulatory regime, Lord Penrose wished to see greater cooperation between prudential regulation and conduct of business regulation.

36. In its response to the Penrose report, Callum McCarthy, the Chairman of the FSA, commented that it had already commenced a programme of reform and modernisation of Life Insurance regulation. The main objective of that programme was described to provide,

> *"Policyholders with greater protection and to improve consumer confidence in the Life industry more generally".*

37. The Commission has also considered the industry-wide consequences for Guernsey of the conclusions and "lessons to be learned" as identified by Lord Penrose. Recently, the Commission has conducted its own review of insurance business in Guernsey and has seen the introduction of the new Insurance Laws. The Commission has agreed a formal Memorandum of Understanding with the FSA with whom it meets on a regular basis, to facilitate the provision of information in relation to issues affecting both the FSA and the Commission, in particular where the FSA is responsible for prudential regulation. The Commission will continue to monitor the developments arising from the Myners' review, the preliminary results of the consultation process on the actuarial profession embarked upon by Sir Derek Morris, and the work of the International Accounting Standards Board, and will report further if it considers that there are developments which may affect the interests of Guernsey policyholders.

Policyholder Compensation - Financial Ombudsman Service and Claims against Equitable Life

38. A policyholder who believes it has a GAR-related complaint about Equitable Life and who has not compromised the right to bring those claims (for instance by being bound under the terms of the Scheme (see paras 3-8 above) may make a complaint to the Financial Ombudsman. The Commission, through its legal advisors, has corresponded with the Financial Ombudsman and has requested clarification of the Ombudsman's jurisdiction to receive claims from Guernsey Branch policyholders. The Financial Ombudsman has unequivocally confirmed that it has such a jurisdiction and will do so. The Ombudsman has an informative website **[Financial Ombudsman Service]** and it contains the following statement which will be of interest to all Guernsey Branch policyholders who believe they may have a valid complaint,

> *"The Ombudsman has also looked at the sale of International Policies by Equitable Life through its Guernsey and Dubai branches and has concluded that our rules do permit us to consider complaints about the conduct and operation of those sales".*

39. We would urge any policyholder considering making such a claim to review the Financial Ombudsman's website which provides a helpful guide to the process.

40. The Financial Ombudsman has already investigated certain "lead cases" on GAR-related claims and has issued adjudications. Further details are available from the Ombudsman's website.

41. Alternatively, a policyholder can seek compensation for a non-GAR claim through the Equitable's own case by case assessment scheme, details of which are to be found on the Equitable website **[Equitable Life]**.

Action Group Initiatives

42. In addition to making claims in the form of complaints to the Financial Ombudsman Service or utilising the Equitable's own assessment scheme, provided they have not compromised their rights, an individual policyholder, or any group of policyholders, may commence legal proceedings in the Courts. High Court litigation is an expensive process. Equitable suggested earlier this year, that they may be prepared to offer financial assistance to policyholders contemplating litigation. However at the Annual General Meeting in May 2004 Equitable's Chairman firmly rejected any such proposition and policyholders must be prepared for the significant financial risks that would result from such a process. Most policyholders will be aware of the activity of the action groups who have assessed the merits of different types of litigation solution and whose own websites contain considerable information which may assist policyholders who are considering such a step. **[EMAG]**. Recently the EMAG action group has been involved in Judicial Review Proceedings to challenge the original decision of the Parliamentary Ombudsman not to reopen her enquiry. We understand leave was granted in favour of the policyholders, although a substantive hearing has not yet taken place, and it may be rendered otiose in the light of the Parliamentary Ombudsman's decision. Also, a certain category of policyholders, namely the with-profits annuitants, have recently commenced group action proceedings against Equitable. The website of the ELTA (Equitable Life Trapped Annuitants) (which can be accessed through the EMAG site) contains information on the activities of this group.

Conclusion

43. The Commission cannot represent the interest of any individual policyholder, nor any specific class of policyholders. Our interests are those of the regulator of Equitable's Guernsey branch business and we must consider issues to the extent that they are relevant to Guernsey branch policyholders as a whole. The Commission is not however and never has been responsible for the Prudential regulation of Equitable which is the rôle of the FSA. We do, however, constantly monitor Equitable issues and will continue to liaise with the FSA and Equitable Life and raise issues with them, the Financial Ombudsman Service and the Parliamentary Ombudsman as we consider appropriate in the interests of Guernsey branch policyholders. We will report any developments which we believe should be brought to the attention of Guernsey branch policyholders through this website.

22nd July 2004